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DOW THEORY LETTERS, INC.

"The Market as Interpreted under the Dow Theory"

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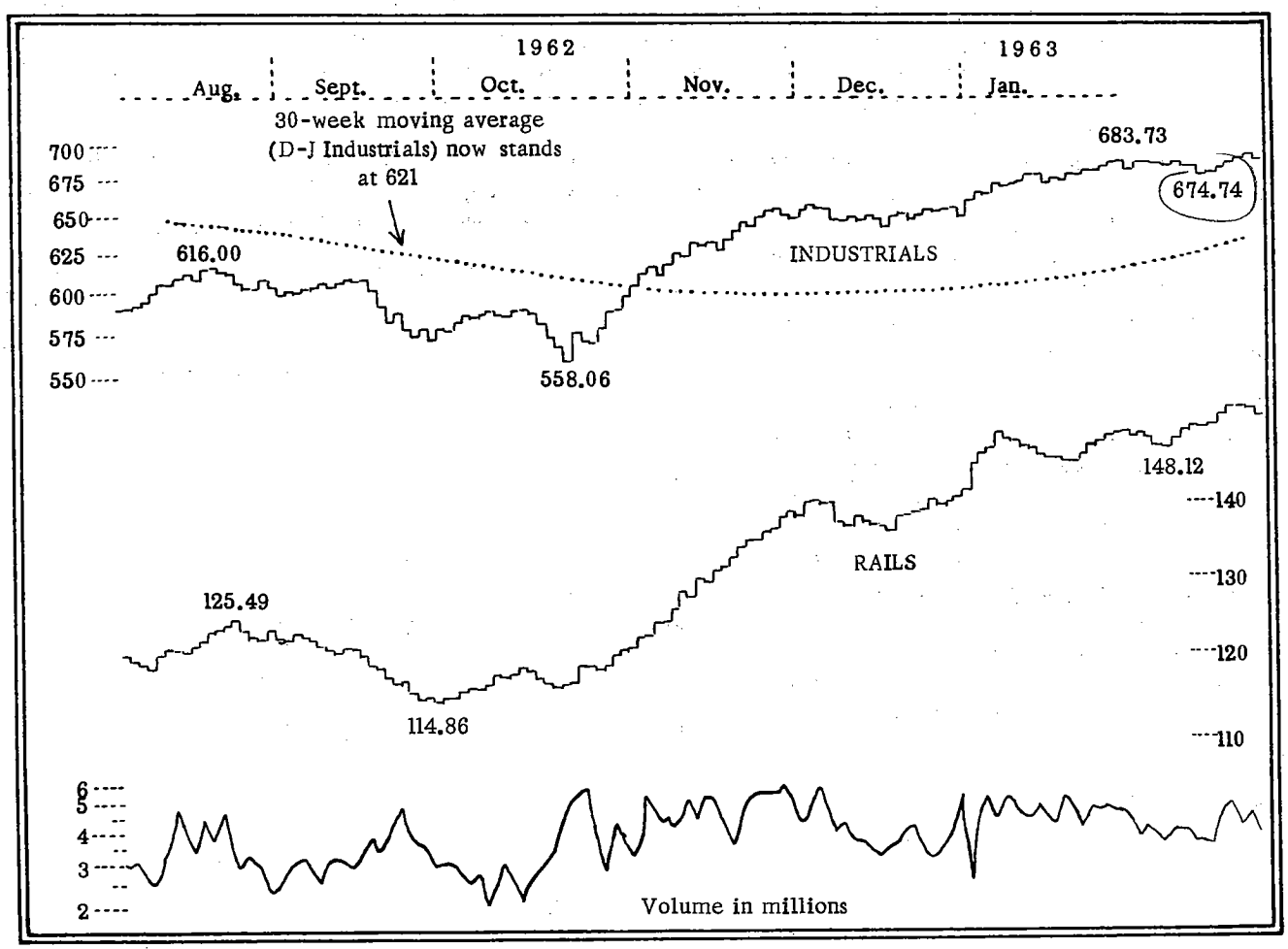
THE MARKET On February 13, Rails pushed above their 1961 peak of 152.92, thus rising to their highest level in three years. A day later Industrials hurdled their January 22, 1963, high of 683.79, and this move was accompanied by a new recovery high in the advance-decline ratio. With all three indicators again "in gear" on the upside, the normal expectation should be for a broadening out of the rise with perhaps a noticable increase in speculative sentiment.

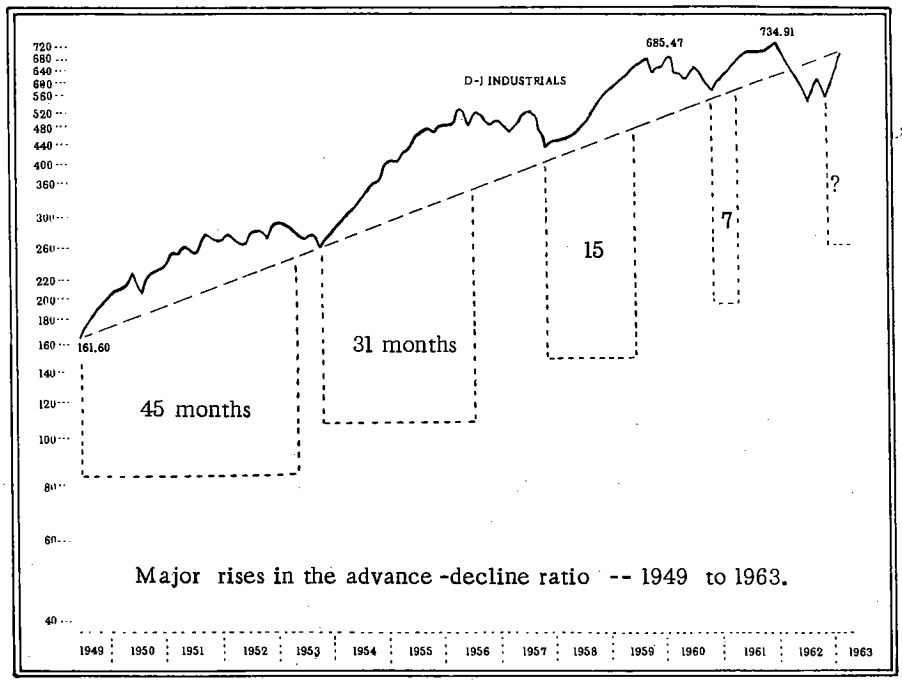
As seen by the action on February 18 (Monday), the 1962-63 advance continues to retain its enigmatic character. On that day Rails diverged while Industrials pushed to a new recovery high. On the same day advances and declines were about equal. New lows rose to 6 (highest since November 28) while new highs were 41 (thus the January 22 total of 66 new highs still stands as the peak for this move). This was followed by a day of decline (Tuesday), but volume contracted sharply with lower prices. New lows increased to 7 on Tuesday.

CONCLUSION: The bullish trend remains in force. The first definitive sign of a reversal would be a joint violation of 674.74 (Industrials) and 143.18 (Rails) on increasing volume.

COMPARISONS One of the tests of the strength of a movement is the duration (length of time) of the rise in the main mass of stocks. Thus, an advance preceded by a substantial base of accumulation may continue for many months or even years. Conversely, an advance built without a solid foundation (i.e., without an extended base) may be violent, but it is generally over rather quickly.



The main upward movements since 1949 (see chart) seem to have had one curious relationship: each has been shorter and steeper than the last.



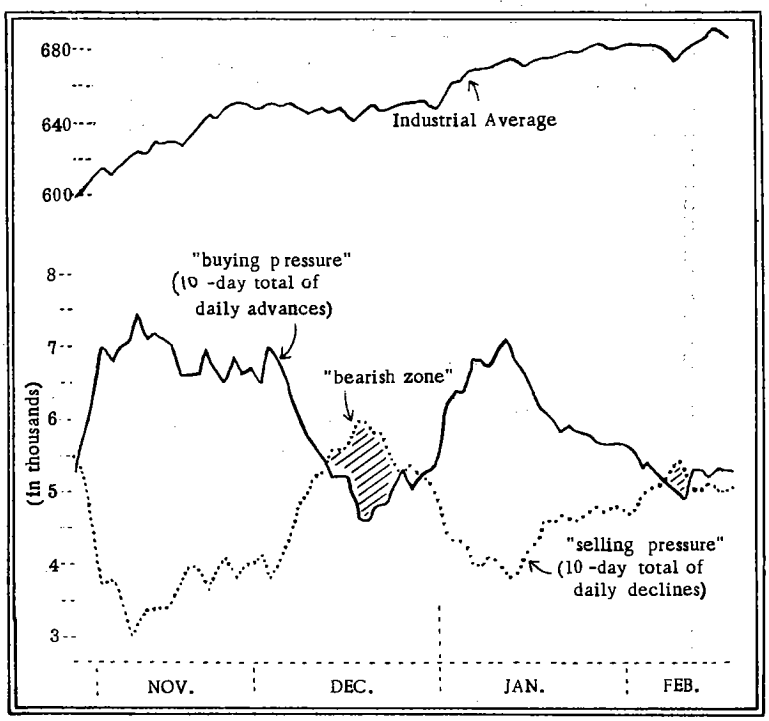
Major rises in the advance-decline ratio -- 1949 to 1963.

The advance-decline ratio is a measurement of the rising or declining tendencies of the majority of stocks on the New York Stock Exchange. As long as the A-D ratio is rising, it can be said that the majority of stocks are tending to rise. The great upward movement in stocks which began in June, 1949, took the A-D ratio higher for 45 consecutive months (the rise ended in March, 1953). The second great major advance began when the A-D ratio turned up in September, 1953. That rise lasted for 31 consecutive months -- until April, 1956. The third important advance started in December, 1957, and continued for 15 consecutive months (it ended in March, 1959). The rather explosive rise which started in October, 1960, ended in March, 1961 -- after only 7 consecutive months.

The current advance started from the low which was reached by the A-D ratio during October, 1962. As of this writing, four months have elapsed. This writer has been wondering whether the current rise will fit into the "time schedule" which has held in effect since 1949. If it does, we might expect the peak of "breadth" (the A-D ratio) to be reached anytime now. Conversely, however, if the A-D ratio continues to rise into the April-May period the rise will then begin to match (in duration) the 1960-61 rise. This would be the first major departure from the pattern of shorter and shorter (in time) A-D ratio rises since 1949.

PRESSURE Visitors to this office usually express interest in a study which I call "buying and selling pressure". This study consists of a 10-day moving average of daily advances and a 10-day moving average of daily declines. When, during a 10-day span (10 days represents a reasonable two-week trend period), more issues have advanced than declined, we can say that the upside pressure (or "urge to buy") is stronger than the downside pressure (or "urge to sell").

The advance-decline lines (see chart) are constantly moving toward or away from each other. If the decline (selling) line is rising while the advance (buying) line is falling, we have a gradually weakening situation. The converse is true if the advance line is trending up while the decline line is trending down. Nevertheless, as long as the advance line is above the selling line we can say that the urge to buy is stronger than the urge to sell. Conversely, when the decline line is above the advance line we know that the selling urge is the dominent one.



The fascinating thing about this study is that if one observes the action of the buying line and selling line over many years, it becomes clear that these two lines cross and recross on an average of about every 15 to 30 days. Occasionally, one of the lines remains above the other for an extremely long period of time and this is a hint that a major move is on. For instance, the advance line held above the decline line for 82 consecutive trading days in the "power rise" of 1960-61. During the 1962 collapse the decline line rose above the advance line on March 22 and held there for 70 trading days.

Thus the graph of the advances and declines as pictured here can tell us (1) the direction of buying and selling pressures, (2) whether buying or selling pressure is the dominent force in the market at any given time, (3) the potential size of a move (is it

extending beyond say 40 or 50 trading days), and (4) the force of one movement as compared to another (for instance, note that the late 1962 rise spread the two lines further apart than did the January, 1963 rise).

One further factor can be gauged by the graph. If the decline rises above the advance line, we can then say that selling is at least temporarily stronger than buying. In a technically weak market, when selling interest dominates it is normal to see the Industrial Average (representative of thirty high-grade stocks) move sharply lower. In a technically strong market, however, we may see the Industrial Average resist the impact of mounting selling pressure in the general market.

The accompanying chart presents an interesting study. Note that the height of buying interest and the depth of selling interest occurred on November 12, 1962. Following November 12, selling pressure rose above buying for nine days -- during which time the Industrial Average held remarkably well. In late December, buying rose above selling again, but note that this time buying interest did not rise as high as in November, nor did selling drop as low.

In mid-January buying began subsiding and selling slowly expanded. Against this action, the Industrial Average simply moved sideways. On February 8 selling rose above buying, but again no important downside pressure came in. As seen on the chart, buying then rose above selling on February 13 (four days later), and the Averages pushed to new recovery highs.

CONCLUSION: The buying-selling graph suggests that the main upward momentum has passed on this rise. However, important selling has not yet come in. Such selling will be identified when the selling line moves above the 6.5 to 7 thousand line on the graph. As long as the two lines stay close together (as they have for the past week) and volume remains relatively high, we can say that the market is "churning".

SUNDRY COMMENTS Professionals never buy or sell a stock because of what they "know about a company". Veteran market men trade cash for stocks or stocks for cash on the basis of what they think "will happen" to a company or to the market. The professional's total concern is with "tomorrow" -- and how stocks will react to future possibilities, -- political, social and economic.

Hamilton often said that a man may posses e xcellent "inside information" regarding a stock or the economy, but he can never know how the market will react to that information.

Several of the nation's most sophisticated and best informed economists have been, and are, quite sceptical about the trend of the economy. Furthermore, their ranks have grown during the past few months. For instance, George Shea, in his front page Wall Street Journal article (February 11, 1963) went so far as to say: "Altogether, the picture given by all these facts is not only one of leveling off but of real hesitation in business. The possibility remains that a new recession has already started or may start very soon. On the other hand the hesitation could be merely a prelude to renewed gains."

The question then arises: supposing a few leading economists are correct -- supposing the economy is contracting. Won't the market cave in when it "finds out about it?" My answer is -- if we are trying to apply fundamental information (regardless of whether that information is correct or not) in an attempt to determine the trend of the market, then we are trying to do the most difficult thing in the world.

For instance, put it that a small group of bearish economists are correct — the economy is now "topping out" and forthcoming business statistics are going to be bad. Does this mean that the market will cave in? Perhaps, but not necessarily. To go a step further: if the March and April statistics appear and they actually are poor, could Congress then react by rushing through a massive tax cut without the so-called "tax reforms"? And if such a tax cut goes through, could not this be taken as highly inflationary? If so, might not the fear of massive inflation send the public into the market in a headlong "flight from the dollar"?

If all this is possible, then bearish economic news in the next month or so might not "break" the market -- it might conceivably send it (temporarily) higher. In other words, a few leading economists may be right (if being bearish is being right) on the economy but wrong on the market. It could happen that way, and therein lies the reason for technical analysis. "The market always does what it's supposed to do," runs the old adage, "but never when it's supposed to do it."

Lastly, is it possible that President Kennedy already senses stout resistance on the part of Congress and the public to his tax cuts, deficits and planned inflation? Did Presidential advisor Walter Heller also sense resistance to planned massive deficits when, on a recent TV appearance, he denounced the "puritan ethic" of the American people? If the Administration detects mounting resistance to tax cuts, what will their next step be? I believe it will be a campaign of fear.

The drama of planned "fiscal arson" may well be unfolding before our eyes. On February 14 President Kennedy announced: "What I am most concerned about is the prospect of another recession. If we don't have a tax cut, it substantially increases the chance of recession, which will increase unemployment, which will increase the size of our deficit."

All of which is augmented by a paragraph from economist Eliot Janeway's latest report: "Flight into Gold? As far as the business public goes, a gold run is as sensitive an issue as the chronic Cuban crisis. Specifically, in terms of the stock market, there's a growing possibility that Wall Street may put on a "flight from the dollar" rally. Such a rally would be highly speculative, and its treacherousness would probably be quick to assert itself. For if a "flight from the dollar" rally were to bring the public into the market, the first consequence of a preliminary run on the dollar would be a money squeeze -- with rates going up and the banks clamping down."

STOCKS Of 350 representative stocks which are tabulated here each week, 265 (76%) are now holding above their 30-week moving average (no change from last week). Of the same stocks, 218 or 62% are now above their August, 1962 high (a rise of 6% from last week).

Stock groups showing most impressive relative strength are Autos, Farm Equipment and Textiles. Retail Stores are turning down, Oils are leveling off, Sulphers are beginning to turn up. Weakest groups are Building Stocks, Machinery, Paper, Movies and Steel (despite talk of steel "stock-piling", note the fading relative strength of the Steels on chart below).

"Throw out" Chrysler and there haven't been many "winners" in this market rise. In Letter 206 (January 10) I included a chart of J.I. Case with the following comment: "The stock has formed one of the few ascending triangles on the board and has more recently broken its downward trend. Case should be a good speculation at this time." The stock was 7 1/2 at that time, but today it has pushed above 10. Case was 39 in 1951, 26 in 1959. A 50% correction from its 1962 low of 4 3/4 to its 1959 peak of 26 could take the stock to 15. Case is beginning to "come alive" and, along with South American Gold and Platinum (see Letter 208), represents one of the few (in my opinion) interesting speculations in the market. Case is the speculative stock in the outstanding (from a relative strength standpoint) Farm Equipment group.

LATE NOTES (Written Wednesday, February 20, 1 P.M., New York time). Industrials are down over 5 points today with Rails down around 40¢. So far, volume has contracted dramatically on all declines. If volume tends to expand on this decline and 674.74 and 148.12 are jointly broken, we will be in trouble. A persistent refusal by one or both Averages to penetrate those points would call for another upward "push".

Charts on this page courtesy of Traders Research, P. O. Box 2466, St. Louis 16, Missouri.